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YOUR TAXES HAVE BEEN GOING UP: CHANGES TO CHILD BENEFITS

June 1987

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WHY YOUR TAXES HAVE BEEN GOING UP: CHANGES TO CHILD BENEFITS

Budget Changes

The May 1985 Budget announced a series of changes to the three federal child benefit programs. After 1990, when these modifications are fully phased in, all families with children will end up with lower child benefits and most will experience tax increases as a result of the reduction in the children's tax exemption.

Since 1973, the **family allowance** has been fully indexed each year to take into account the rise in the cost of living as measured by the Consumer Price Index. The May 1985 Budget marked a retreat from full indexation. From 1986 on, the family allowance will be partially indexed each year to the amount of inflation over three percent.


The **child tax credit** was raised from \$384 per child in 1985 to \$454 for the 1986 taxation year and will climb to \$489 in 1987 and \$524 in 1988. From 1989 on, annual adjustments of the child tax credit will be limited to the same inflation-over-three percent indexation formula as the family allowance. The 'turnover point' (the level of net family income above which the child tax credit is reduced by five cents for every dollar) was lowered from \$26,330 to \$23,500 for 1986 and thereafter will be partially indexed by the amount of inflation over three percent.

The **children's tax exemption** is being reduced from its current \$710 per child to \$560 in the 1987 taxation year and \$470 in 1988. From 1989 on, the children's tax exemption will be set at the amount of the family allowance. In effect this means that the family allowance will become an untaxed benefit since the tax savings from the exemption will offset the income tax paid on the family allowance.

The Effects of the Child Benefit Changes

Table 1 charts the changes in federal child benefits from 1986 through to 1990. The switch from full to partial indexation lowered the annual family allowance from \$390 to \$379 per child in 1986; by 1990 we project the amounts to be \$457 and \$395, respectively. The child tax credit reaches an estimated \$534 by 1990 under the new system as opposed to \$468 under the old. By contrast, the children's tax exemption is substantially less in 1990 (\$395 versus \$710 per child) as a result of the 1985 budget.

Table 2 shows the impact of the child benefit changes for a two-earner couple supporting two children on spouses' earnings of \$20,000. Such a family can be classed as 'working poor' since its earnings are \$5,345 below the estimated \$25,345 poverty line in 1990 for a family of four living in a metropolitan center of 500,000 or more. Even adding in the family allowance and child tax credit, the family's total income - \$20,924 - is several thousand dollars under the low-income line.



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Table 1

**Federal Child Benefits, Before and After 1985 Budget,
1986-1990**

Annual Benefits						
	<u>Family Allowance</u>		<u>Child Tax Credit</u>		<u>Children's Tax Exemption</u>	
	<u>before</u>	<u>after</u>	<u>before</u>	<u>after</u>	<u>before</u>	<u>after</u>
1986	\$390	\$379	\$400	\$454	\$710	\$710
1987	406	383	416	489	710	560
1988	422	387	433	524	710	470
1989	439	390	450	529	710	390
1990	457	395	468	534	710	395

Table 2

**Federal Child Benefits, Before and After 1985 Budget, Working Poor
Two-Earner Couple With Two Children, 1990**

<u>Child Benefit</u>	<u>Before Budget</u>	<u>After Budget</u>	<u>Change</u>
family allowance	\$ 670	\$ 572	\$ -98
child tax credit	900	1,058	+158
children's tax exemption	391	227	-164
total	1,961	1,857	-104

Note

1. Family earns \$20,000, which is \$5,345 below the estimated \$25,345 poverty line for a family of four living in a city of 500,000 or more in 1990.
2. Family allowance is net (after-tax) amount.
3. Child tax credit is for the 1989 taxation year, payable in 1990.

The working poor family's net (after-tax) family allowance in 1990 comes to \$572 or \$98 less than if the system had remained fully indexed. It receives \$1,058 worth of child tax credit as opposed to \$900 under the old system, for a gain of \$158. However, it loses \$104 in tax savings because the children's tax exemption is less. (Our calculations also take into account the partial indexation of tax brackets and personal exemptions, another change introduced by the May 1985 Budget.) Thus the increase in the child tax credit is more than offset by the decline in the family allowance and children's tax exemption. In the end, the family's total child benefits are \$104 less under the new system (\$1,857) than under the old one (\$1,961).

Table 3 extends the analysis to show total child benefits for couples at various earnings levels. Only the poorest families, with no employment earnings, get more total child benefits. The increase in the child tax credit as a result of the May 1985 Budget more than offsets the loss in the family allowance; because these families have no earnings, they are below the taxpaying threshold and so do not benefit from the children's tax exemption. However, their boost in total child benefits is a modest \$34 in 1990 and from 1991 on they will be worse off because both the child tax credit and the family allowance are partially indexed to the to the cost of living.

All other families shown in Table 3 lose total child benefits in 1990 because of the changes brought about by the federal budget of 1985. For the large majority of families (those earning \$15,000 or more) the key factor is the loss in tax savings from the children's tax exemption. The higher their income, the greater their loss in tax savings from the children's tax exemption (which amounts to a tax increase) and their loss in overall child benefits. Figure A illustrates these changes.

Despite the increase in the child tax credit, many poor and all middle and upper-income families will receive lower overall child benefits as a result of the reduction in the children's tax exemption (which amounts to a tax increase) and the partial indexation of the family allowance. The losses will mount with each passing year. After the various changes are fully phased in 1990, all families - the poorest included - will get less than they would before the 1985 Budget's changes because the federal child benefits system will fail to keep pace with inflation.

Table 3

**Impact of 1985 Budget on Federal Child Benefits, Two-Earner Couple
With Two Children, 1990**

Total Child Benefits

<u>Family Earnings</u>	<u>Before Budget</u>	<u>After Budget</u>	<u>Change</u>
\$ 0	\$1,814	\$1,848	\$ +34
10,000	1,944	1,848	-96
20,000	1,961	1,848	-113
30,000	1,901	1,690	-211
40,000	1,451	1,231	-220
50,000	1,092	790	-302
80,000	1,107	790	-317
100,000	1,146	790	-356

Note

Total child benefits are sum of net (after-tax) family allowance, child tax credit and tax savings from children's tax exemption.

